July 2, 1992 CD-92-06 LDV/ICI/SM

Dear Manufacturer:

Subject: Calculation of Domestic Content for Carline Classification

Enclosed, for your information, are copies of several letters we received from Honda, North America, Inc. and our responses to their questions on domestic content determinations. We believe these answers are consistent with previous guidance and believe that most manufacturers are accounting for domestic content accordingly. The enclosed letters discuss the definition of "component", situations that EPA views as "substantial transformations", acceptable methods for tracking declared value of components, and provisions for obtaining EPA approval to track groups of components rather than tracking each component separately.

Recently, EPA has completed a series of special audits of the methods used by manufacturers to determine the domestic content of their carlines and classify carlines as "domestic" or "non-domestic" for CAFE calculation purposes. At this point, all manufacturers which have assembly plants in the United States have been audited. As a result of these audits, EPA has learned that many manufacturers have been grouping components for tracking purposes. This was particularly true in the case of contractor-supplied assemblies that consisted of multiple components. In these cases, manufacturers generally attributed the entire cost of the assembly to the category based upon the address of the contractor.

EPA also learned that some manufacturers were not explicitly tracking the declared value of imported components and were instead using other figures which they felt were equivalent. There were also other miscellaneous discrepancies from the procedures which the manufacturer felt did not impact the quality of the results. Often these procedure variations were not explicitly approved by EPA. For the most part the procedures which were audited meet the conditions for approval discussed in the enclosed letters.

EPA needs to formally document all these procedures. Consequently, EPA requests that manufacturers which are currently grouping components for tracking purposes (based on the definition of a component contained in the enclosed letters), or are using other variations to the prescribed procedures, substantiate their

practices and obtain EPA approval. This approval and documentation process should be completed before submitting CAFE calculations for the 1992 model year.

As discussed in the enclosed letters, EPA will be carefully scrutinizing cases were the domestic content levels are near the cutpoint between "domestic" and "non-domestic" classification (75 percent domestic content). EPA will be much more likely to approve alternative methods when only a small portion of the cost is attributed to one source category and when the manufacturer can demonstrate that the alternative methods clearly will not frustrate the proper classification of the carline in question.

Lastly, EPA requests that manufactures submit the import content percentage for each carline as part of the CAFE report starting with the 1992 model year. This information is required to be calculated and aids in EPA's review of the classification of the carlines.

If you have any questions or comments, please contact Mr. Eldert Bontekoe at (313).668-4442.

Sincerely,

Robert E. Maxwell, Director
Certification Division
Office of Mobile Sources

Enclosures

March 19, 1992

Mr. Eiji Amito
Senior Vice President
Honda North America, Inc.
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Suite 5300
Washington, DC 20024

Dear Mr. Amito:

As you requested, I would like to clarify the phrase "indivisible component" used in my November 22 letter. The phrase was coined to cover a type of 'component' that was made exclusively of raw materials and generic parts (thereby meeting EPA's suggested definition of a "component"). This usage was explained parenthetically in my letter. There was no suggestion made nor intended that the method of connecting multiple EPA-defined "components" has any bearing on domestic content determinations. If a part consists of multiple "components" then the individual components should be tracked regardless of the permanence of the fastening.

The two examples which you raised are discussed below:

Example One:

Classification of the instrument panel as a distinct "component" or as an assembly (of separate components) would depend on manufacturing (or assembly) methods used. EPA would consider the instrument panel to be a "component" if it was assembled from raw materials or generic parts. In your example, you identify four elements that are assembled in the US to make an instrument panel: foam, plastic sheeting, plastic substructures, and metal reinforcements. The following paragraphs discuss how to classify each element.

If the foam was molded in the assembly process, then the resins and hardeners used to make the foam would be considered raw materials. However, if the foam was purchased as a molded piece, it would no longer be considered a raw material or a generic part and should be tracked as a separate "component".

If the plastic sheeting was received on a roll and was cut to size and bonded to the foam as part of the assembly process, the plastic sheeting would be considered a generic part. However, if the sheeting was pre-cut or otherwise fabricated into a non-generic shape or form, it would no longer be considered a raw material or a generic part and should be tracked as a separate "component".

If the plastic substructures were assembled as part of the instrument panel assembly process from standard plastic stock (not pre-cut or special molded pieces), then plastic substructures would be considered a generic part. However, if the substructure was purchased as an assembled structure, or the pieces arrived in pre-cut sections, or were specially molded, it would no longer be considered a raw material or a generic part and should be tracked as a separate "component".

Lastly, if the metal reinforcements were cut or machined from standard sheets or bar stock (etc.) and assembled as part of the instrument panel assembly process from standard metal stock (not pre-cut or special fabricated pieces), then the metal reinforcements would be considered a generic part. However, if the reinforcements were purchased as an assembled structure, or the pieces arrived in pre-cut sections, or were specially fabricated, it would no longer be considered a raw material or a generic part and should be tracked as a separate "component".

If <u>all</u> the elements that are needed to assemble an instrument panel can be classified as generic parts or raw material, then the whole instrument panel would be a "component" and it should be tracked as a unit. In your example, the instrument panel is assembled in the United States, so the entire cost of the instrument panel would be considered "domestic".

On the other hand, if any element needed to assemble an instrument panel is considered a "component" then its cost (declared value) must be tracked separately. If a "component" is imported into the United States, then its declared value must be included in the aggregate declared value of all imported components and placed in the numerator of the required EPA import ratio equation.

Example Two:

In this example, a circuit board is assembled abroad using, in part, United States-manufactured semiconductors. The classification of the circuit board depends on whether it is made entirely of raw material and generic parts or whether it is made of "components". Semiconductors would be considered generic parts if they were widely available parts which were not specifically designed for your application. Custom-designed semiconductors would not be considered generic parts and would be classed as "components". Purchased plug-in boards consisting of multiple semiconductors used in assembling a "mother-board" circuit' would normally not be considered generic parts and would be classified as "components".

The Cost Accounting in Example Two:

In your example, the circuit board assembled abroad would always be considered an imported part. However the import declared value of the circuit board would vary depending on situations.

If the circuit board consists of "components", then the value of those components must be tracked separately. If a "component" is manufactured in the United States (or Canada) and exported abroad for assembly (your example), then the value used in the EPA import content calculation would be the declared value of the imported circuit board minus the declared value of all domestically produced "components". If the components were also manufactured abroad, the entire declared value of the circuit board would count as import.

If the circuit board consists only of generic parts then the whole cost of the circuit board would count as import regardless of the source of the generic parts. Tracking of raw material or generic parts is not required.

EPA Approval for Tracking Assemblies Rather than Individual Components

EPA may approve a manufacturer's request to track a limited number of components as a group (an "assembly"), if EPA is able to conclude with a high degree of confidence that this gross level of tracking will not frustrate the intent of the regulations to properly classify carlines into "domestic" and "non-domestic" categories. The closer a given carline comes to the 75 percent demarcation line between domestic and non-domestic categories, the less the likelihood of EPA allowing a grouping of components for cost tracking purposes.

A proposed procedure must also be periodically reviewed to assure it has the necessary oversight and control to catch significant unexpected changes. Advance approval by EPA would be required before such a plan could be implemented.

Normally, EPA would approve situations where only a very small percentage of the projected cost of an assembly is attributed to one source category (e.g., 95% of the cost was imported). Even in such cases, the manufacturer would be required to show that there was not a systematic bias that would affect proper categorization.

In some rarer cases, EPA may approve the grouping of components as an assembly for cost tracking purposes when the costs were more nearly evenly split. Such an approval may occur if a manufacturer could show, for example, that only one part (or several parts) was imported and its total cost was low - consequently its classification would have little affect on the overall calculation. In this case EPA might allow tracking the assembly as a group.

If EPA allowed tracking of groups of components as a single assembly, the classification would be based on the majority source of cost. For example, if the assembly were 51 percent domestic, the entire cost would be counted as domestic.

If you have any further questions on this matter you may contact myself or Mr. Eldert Bontekoe at (313) 668-4442.

Sincerely,

Robert E. Maxwell, Director
Certification Division
Office of Mobile Sources

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HONDA
HONDA NORTH AMERICA, INC.
955 L'ENFANT PLAZA S W SUITE 5300
WASHINGTON. D C 20024 (202) 554-1650

January 3, 1992

Mr. Robert Maxwell
Director
Certification Division
U.S. Environmental Protection Agency
Ann Arbor, Michigan 4810

Dear Mr. Maxwell:

Thank you for your letter of November 22 providing guidance about EPA's regulations regarding domestic content calculation procedures. Your guidance will enable us to make progress toward developing our detailed procedures for determining domestic content. We do, however, have a few additional questions that arise from your recent letter.

First, we would like to clarify the concept of "indivisibility" of a component to ensure that we are correctly applying this concept in our procedures. Your suggested definition of "component" is a part made from raw materials and/or generic parts. In responding to our specific examples, however, you suggested that the test is whether the part is "indivisible," which in turn is described as "made from raw materials or generic parts."

We are uncertain whether you intended the concept of "indivisibility" to be a synonym for manufacturing a part from raw materials or generic parts; or whether you intended to apply the concept of "indivisibility" to some components that are made from materials other than raw materials but which, as a practical matter, cannot be redivided after they are manufactured.

We have two hypothetical examples that illustrate the question of applying the concept of "indivisibility," and would appreciate your interpretation as to whether each part is a "component" or "an assembly of distinct components," for purposes of your regulations.

Example One: An instrument panel is made in the United States by combining four elements, some of which are imported: foam plastic sheeting, plastic substructures and metal reinforcements. Two of the four elements --the plastic substructures and the metal reinforcements--are made separately from "raw materials" or "generic parts," so each of these elements would be a "component" under your suggested definition. It would seem that under your definition, the plastic sheeting is also a component since it is not generic and since it is

Please wear your seat belt and drive safely

manufactured from more than one type of plastic (the raw materials). The foam would seem to be raw material although its exact formula is probably proprietary. During the process o. raking the instrument panel, the foam is permanently bonded to the plastic sheeting, and the plastic substructures and metal reinforcements are permanently molded into the resulting panel. The instrument panel is "indivisible" in the sense that after molding it is impossible to separate the elements of the panel without destroying the panel and the original elements. In that context, the manufacturing of the instrument panel could be said to "substantially transform" the foam, sheeting, etc. into a "new article of commerce," i.e., an instrument panel. In other words, once the plastic sheeting is bonded to the foam, and the plastic substructures and metal reinforcements are incorporated in the foam, the components are "indivisible" for all practical purposes.

Under your suggested definition, is the instrument panel a "component" because it is indivisible? Or is the instrument panel an "assembly of distinct components" because it was not made directly from raw materials or generic parts?

Example Two: Circuit boards are made abroad, using (among other things), U.S.-manufactured semiconductors and foreign-made generic parts (such as wires). Although some semiconductors are ordered from catalogues (in which case we assume you would consider them "generic parts"), it is also common to use custom-designed semiconductors in the circuit boards. A circuit board may contain both "generic" semiconductors and custom designed semiconductors.

Under your suggested definition, we assume that circuit boards are assemblies of semiconductors and generic parts. Is the circuit board, itself, an imported component? If the answer is yes, should the value of the domestically manufactured semiconductors be subtracted from the value of the imported circuit board in the regulatory formula? Or, should the entire value of the imported circuit board be included in the regulatory formula? If your answer is that the circuit board is not an "imported component," should its value be excluded altogether, because only "imported components" are to be included in the numerator of the regulatory ratio?

Our second group of questions relates to your suggestions for cost accounting methodology. One alternative you suggest to obtain EPA approval to "classify the entire assembly based on the preponderance of cost," assuming generally equivalent results to reliance on actual declared value. Our question relates to hypothetical part that is assembled in the United States from

several distinct components, all of which are imported. The value of the imported components is 85% of the value of the part; the labor involved in assembly adds another 15% to the value of the part. Under your alternative method of "classifying the entire assembly," the entire part would be classified as "imported" because the preponderance of the cost is attributable to imported content. Would the entire value of the part then be Included in the numerator of the regulatory ratio, because the entire part is deemed "imported"? Or, would it be your intention that we would include only 85% of the cost of the part, as that is the amount derived from imported parts?

We appreciate your continued assistance in our effort to develop procedures.

Sincerely,

Eiji Amito
Senior Vice President
and Technical Representative

November 22, 1991

Mr. Eiji Amito
Senior Vice President
Honda North America, Inc.
955 L'Enfant Plaza, SW
Suite 5300
Washington, DC 20024

Dear Mr. Amito:

I am replying on behalf of Mr. Wilson to your October 18, 1991 letter regarding domestic content calculation procedures.

It is not the intention of 40 CFR 600.511-80 (b) (2) (i) to treat parts made of distinct components ("assemblies") assembled in the United States as "domestic" without regard to the country of origin that supplied components used in its assembly. This regulation section refers to "wholly the ... manufacture..." (emphasis added) which clearly establishes that the measure of this section exceeds the simple "manufacture" definition of 40 CFR 600.002 (a) (1). EPA, in its letter to Ford Motor Company dated February 7, 1986, states that parts which are composed of individual components must be considered on the component basis rather than on an entire assembly basis. As you noted in your letter, EPA provided general guidance that a "component" could mean "anything which carries an individual part number and which can be ordered as a replacement part", excluding raw materials and generic parts such as screws. However, as pointed out in that letter, this guideline was prompted by a concern that manufacturers may be defining the term "component" too broadly. It was not meant to be a strict rule. If there are cases where applying this definition results in inaccuracies in determining domestic content, then it would be more appropriate to use a more detailed definition of component. The goal should be to provide the most accurate accounting of the domestic content within reasonable limits.

It is the intention of the foregoing that the manufacturer should track declared value of individual components (per EPA's suggested definition). For each imported component the manufacturer should know the declared import value and should include this value when calculating the required ratio of declared

value divided by the cost of production. If the exact declared value is unavailable, EPA will consider alternative sums which closely approximate the declared value and lead to appropriate domestic content decisions.

By EPA's suggested definition, a "component" would be made of raw materials and/or generic parts. It would not be necessary to track the source of these raw materials and/or generic parts used in the manufacture of such a component because EPA views that the manufacture or assembly of such a component constitutes a "substantial transformation into a new and different article of commerce" from its raw material and generic parts. Consequently knowing the point of assembly or manufacture of such a component determines its origin for domestic content determination.

EPA allows manufacturers to obtain specific rulings as to what constitutes a component. Also EPA may, at its discretion, find that a cost tracking scheme satisfactorily meets the intention of the regulations if a limited number of components are grouped together and tracked as an assembly. The key element in EPA's decision would be whether the cost tracking mechanism resulted in correct domestic versus non-domestic classifications and showed appropriated oversight and control to ascertain unexpected changes. It is not EPA's intention to require new or complex tracking mechanisms if an alternative method satisfactorily meets the intent of the regulations and results in appropriate classifications.

Regarding your questions concerning how to count assemblies (of multiple components) which are purchased from US suppliers but known to contain components of foreign origin, EPA is prepared to accept two cost accounting methods. The prefered method would be to determine the actual declared value of all imported components contained in the assembly and use these values when calculating domestic content levels. As an alternative, the manufacturer may obtain approval from EPA to classify the entire assembly based on the proponderance of cost, if the manufacturer can satisfactorily show that this method yields equivalent results to an actual cost accounting on the aggregate.

The following portion of the letter addresses your four hypothetical examples.

<u>Example One</u>

EPA would view the seat belt assembly as an assembly of individual components since the parts (retractor, webbing, and tongue) are neither generic parts nor raw materials. Consequently, the manufacturer would either (1) track the components separately or (2) obtain EPA approval to track the entire assembly (and classify its origin upon the proponderance of its cost) after showing that this method yielded substantially equivalent results as tracking the components individually.

Example Two The answer provided to Example One applies here also.

Example Three
The answer depends upon whether the "component" purchased consists of components or is, itself, an indivisible component (made from raw materials or generic parts). If the component is indivisible, then the classification would be made based on its point of manufacture, which based on the example would result in a "domestic" attribution. If the component was an assembly of distinct components, then the answer provided to Example One would apply here as well.

Example Four
As discussed in answering the last, question, the answer depends whether the "component" is an indivisible component (made from raw materials or generic parts). If the component is indivisible, then the classification would be made based on its point of manufacture, which based on the example would result in a "non-domestic" attribution. If the component was an assembly of distinct components, then the answer provided to Example One would apply here as well.

If you have any further questions on this matter you may contact myself or Mr. Eldert Bontekoe at (313) 668-4442.

Sincerely,

Robert Maxwell, Director
Certification Division

Control # OMS-91-0095

HONDA

HONDA NORTH AMERICA, INC.

Mr. Richard D. Wilson
Director, Office of Mobile Sources
U. S. Environmental Protection Agency
401 M Street, S.W.
Washington, D.C. 20460

Dear Mr. Wilson:

As Honda increases the number of automobiles manufactured in the United States and expands the local sourcing of auto parts used in its automobiles, the domestic content of certain Honda car lines is increasing. While at this time the import content of each Honda car line remains well above the threshold specified in the Federal fuel economy laws (25% import content), the increasing amount of domestic content in our automobiles makes it necessary to develop detailed procedures for the determination of the domestic content of our car lines pursuant to 40 C.F.R. 600.511. Indeed, your Certification Division has requested that we develop such procedures.

In developing a system for determining the domestic content of our car lines, we have encountered several questions of regulatory interpretation. We are writing to obtain your guidance in understanding the requirements of the regulations, So that we may complete the outline of procedures requested by your staff.

Our questions arise from our efforts to implement the requirements of §600.511, relating to the determination of domestic content. This section requires a manufacturer to quantify the declared value to Customs of "all of the imported components" installed on the car line in a model year. Subsection (b)(2) provides that "components shall be considered imported" unless they are either "wholly the growth, product or manufacture of the United States and/or Canada" or "substantially transformed in the United States or Canada into a new and different article of commerce." Each component must be classified as "domestic" or "import;" there is no category of "mixed origin" component. Title V of the Motor Vehicle Information and Cost Savings Act contains the definitions used in the EPA regulations (according to §600.002(a)(1)). The relevant part of the definition defines "manufacture" as "to produce <u>or assemble</u> in the Customs territory of the United States." (Emphasis added). As a result of this definition, it appears that a component that is "wholly assembled" in the United States must be treated as a "domestic" component, even if it is assembled from foreign sourced subparts. Please confirm that this interpretation

is correct. If this interpretation is not correct, how should we classify those components that are wholly assembled in the United States from a mixture of domestic and foreign subparts?

Our second group of questions arises from the Certification Division's letter to Mr. D.R. Buist of Ford Motor Company dated February 7, 1986, relating to the proper valuation of domestic content. In that letter, which was written in the context of components that were assembled overseas, EPA determined that parts used in the assembly of larger or more complex components could themselves be "components" under the regulations. The letter then defined the term "component" to mean "anything which carries an individual part number and which can be ordered as a replacement part," excluding raw materials and generic parts such as screws. How does this interpretation apply to a component wholly assembled in the United States (and, therefore, "wholly manufactured" in the United States)? As noted above, the regulation would seem to designate components fully assembled in the United States as "domestic" components, even if they were assembled from foreign sourced subparts. However, if every item carrying an individual part number and capable of being ordered as a replacement item is also a "component," should Honda include in the import content of its car lines the value of the import content of U.S.-assembled components, if the subparts separately qualify as "components?" Is there a criterion beyond the assignment of a part number and availability as a replacement part that should be used to distinguish "components" from subassemblies or subparts on which further assembly or manufacturing is required before the component is ready for installation on the automobile?

Our third group of questions relates to the proper classification of components purchased from U.S. vendors. If Honda purchases from a U.S. vendor a component that is labeled to show foreign origin, or is otherwise known to Honda to be of foreign origin (such as through vendor request for a foreign exchange rate adjustment), how should the component be classified? If it should be classified as "imported," how should Honda (who was not the importer) determine the "declared value" to Customs of the imported component for purposes of preparing the ratio under §600.511(a)(1)? Is it sufficient to make a good faith estimate of the "declared value" to Customs if the supplier is unwilling to reveal the actual "declared value"? If the origin of the component purchased from a U.S. vendor is not identified, and the vendor has not requested a foreign exchange rate adjustment, should Honda assume that the part is domestic?"

We have developed four hypothetical examples illustrating the questions we raised above. We would appreciate your views on the proper classification -domestic or import-of each of these four components.

Example one: A seat belt assembly is purchased from a U.S. vendor, and is labeled "Made in the U.S." The assembly consists of a seat belt retractor, webbing and the tongue portion of the buckle. The seat belt retractor is assembled overseas, and the webbing is attached to the retractor overseas. The tongue is made overseas. The work done in the United States consists only of sewing the tongue to the webbing. Although all three subparts have separate part numbers, they are not able to be ordered separately as replacement parts. If replacement were necessary, the entire assembly would be replaced. Should this unit be classified as "domestic," since the subparts did not meet your definition of "component" until they were combined in the United States into a completed seat belt assembly? Or, should this unit be classified as "imported" because the work done in the United States was so minimal that it could not properly be considered as "wholly assembled" in the United States?

Example two: A component is purchased from a U.S. vendor, who fully assembles the unit in the United States from seven subparts. Five of the seven subparts, including the most complex and expensive ones, are imported, and two are made in the United States. Six of the seven subparts have part numbers and are capable of being ordered as replacement parts. In fact, many subparts within the subparts themselves have part numbers and are capable of being ordered as replacement parts. Should this component be classified as "domestic," since the final stage assembly was wholly performed in the United States? If so, should the five imported subparts that meet your definition of "component" nonetheless count as imported content? Or, should the entire unit be classified as "import," because the substantial amount of overseas subassembly work makes it impossible to consider the unit as "wholly" assembled in the United States?

Example three: A component is purchased from a U.S. vendor, who fully assembles the unit in the United States from six subparts. All of the subparts are imported; however, none of them has a part number and none is capable of being ordered as a replacement item. If the component becomes damaged in use, the entire component must be replaced. The value of the imported subparts is approximately 85% of the value of the completed component; the U.S. assembly adds only about 15% to the value of the product. Should this component be classified as "domestic"? If so, is the rationale that none of the subparts meet your definition of "component," of that the final stage component was fully assembled in the United States? On the other hand, should this component be classified as "import" because the substantial majority of the value of the product is from the imported subparts, even though it was fully assembled in the United States?

Example four: A switch is wholly assembled in Mexico from parts that originated in the United States. These parts are exported to Mexico for assembly into a switch, then reimported into the United States as a finished product. The value added in Mexico is less than 10% of the value of the completed component. Should this component be classified as "import" because it was not "wholly manufactured in the United States," and thus appears to be "imported" pursuant to §600.511(b)(2)? If so, should the full amount of thee "declared value" of the imported component be used for purposes of preparing the ratio for computing domestic content under §600.511(a)(1)? If you believe that the component should not be classified as "imported," do you base that conclusion on the small value added outside the United States? Does it make any difference in analyzing this hypothetical whether the U.S.-originated parts would themselves qualify as "components" under your definitions?

We look forward to your responses. As soon as we have received them, we will complete the outline of our procedures in accordance with your guidance and will forward the outline to your staff.

Sincerely,

Eiji Amito
Senior Vice President
and Technical Representative